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CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 511.

In the Matter of

THE PEORIA AND EASTERN RAILWAY COMPANY.

INCOME BONDHOLDERS OF THE PEORIA AND EASTERN RAILWAY COMPANY,

Petitioners,

v.

THE NEW YORK CENTRAL RAILROAD COMPANY, THE CLEVELAND, CINCINNATI, CHICAGO AND ST. LOUIS RAILWAY COMPANY and THE PEORIA AND EASTERN RAILWAY COMPANY.

BRIEF OF RESPONDENTS, THE NEW YORK CENTRAL RAILROAD COMPANY AND THE CLEVELAND, CINCINNATI, CHICAGO AND ST. LOUIS RAILWAY COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI.

GERALD E. DWYER,
Counsel for Respondents, The New York Central Railroad Company and The Cleveland, Cincinnati, Chicago and St. Louis Railway Company.

SAMUEL H. HELLENBRAND,
LEE P. GAGLIARDI,
Of Counsel.

THE COURT PRESS, N. Y. C.

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Statement.

Petitioners, Income Bondholders of The Peoria and Eastern Railway Company, seek a writ of certiorari to review a final decree of the United States District Court for the Southern District of New York, settling and stating as of December 31, 1945, the intercompany accounts between the Peoria and Eastern and the Operating Companies.* The decree was

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* The parties will be referred to herein as follows:
Peoria and Eastern—The Peoria and Eastern Railway Company
New York Central—The New York Central Railroad Company
Big Four—The Cleveland, Cincinnati, Chicago and St. Louis Railway Company
Operating Companies—New York Central and Big Four

entered upon the unanimous decision (*Ewen, et al.* v. *Peoria and Eastern Railway Co.*, 78 F. Supp. 312) of a three-judge Special Court consisting of Chief Circuit Judge Learned Hand and District Judges Coxe and Hincks, substantially confirming the report of a special master made after extended hearings which involved some 4000 pages of testimony and 577 voluminous exhibits.

The proceeding before the Special Master arose out of and is supplemental to a railroad adjustment proceeding brought by the Peoria and Eastern under the provisions of former Chapter XV of the Bankruptcy Act (53 Stat. 1134).* By decree entered July 8, 1940 (*Ewen, et al.* v. *Peoria and Eastern Railway Co.*, 34 F. Supp. 332, cert. denied 311 U. S. 700), and order supplemental to decree dated April 29, 1941 (*In re Peoria and Eastern Railway Company*, 37 F. Supp. 917, cert. denied 314 U. S. 635), the Special Court granted the petition of the Peoria and Eastern for adjustment of its maturing bond indebtedness, but made no adjudication with respect to the amount and validity of the accounts between the Peoria and Eastern and the Operating Companies, leaving all questions concerning them open and reserved for future determination. In April, 1943, the Special Court granted the petition of the Operating Companies for the appointment of a special master to hear and report on the amount and validity of the inter-company accounts.

From the beginning of its corporate existence in 1890 the railroad of the Peoria and Eastern has been operated by the Big Four (and, subsequent to 1930, by the New York Central under its lease of the Big

* Printed as Appendix to petition for certiorari.

Four) under the provisions of an Operating Agreement (Ex. 11, S. 160)* entered into in 1890 between the Big Four and the reorganization committee of the insolvent predecessor of the Peoria and Eastern.

This Operating Agreement was part of a comprehensive plan of reorganization adopted by the reorganization committee and security holders of the insolvent company (Ex. 3, S. 156—in part—). The salient features of this plan (the third foreclosure and reorganization of the same line of railroad within a ten year period) included the sale to the Big Four of the easterly segment of the railroad running from Indianapolis, Indiana to Springfield, Ohio; the conveyance to the newly incorporated Peoria and Eastern of the westerly segment of the road running from Indianapolis, Indiana to Pekin, Illinois; the issue by the Peoria and Eastern of First Mortgage 4% bonds, Second Mortgage non-cumulative 4% Income Bonds and capital stock to be exchanged for various securities of the predecessor company; a guarantee by the Big Four of payment of the interest on the Peoria and Eastern first mortgage bonds and the prior bonds of the predecessor companies of the Peoria and Eastern; and the delivery to the Big Four of half the authorized capital stock of the Peoria and Eastern as consideration for its entering into an agreement for the operation of the railroad of the Peoria and Eastern (Findings 5-9, 13, S. 108; Exs. 3-9, 11, S. 160).

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* Since petitioners are moving to dispense with the printing of the record and have printed only a few selected documents as Supplement 1 to their petition, our references to matters printed therein will be designated "S. . . ."; where we refer to matters not printed in Supplement 1 our references will be to exhibits and typewritten minutes in the record before the Special Master. References to the report of the Special Master will be made as "S. M. . . .".

The plan of reorganization was consummated by the execution of the necessary documents on February 22, 1890 (Exs. 5, 10, 11, 13, S. 178) and the Big Four thereupon commenced its operation of the railroad of the Peoria and Eastern.

The Operating Agreement (Ex. 11, S. 162) recites:

> "WHEREAS the railways of the parties hereto connect at Indianapolis, and it will be beneficial to the business and traffic of said railways that the same be put under one management:"

and provides that the Big Four "contracts and arranges with the Peoria Co. for running the railroad of the Peoria Co."; the Peoria and Eastern grants to the Big Four "the right to use and operate" its railroad and the Big Four agrees that it will "use, maintain and operate" the railroad (Article First). The Big Four agrees to make all necessary expenditures (Article First) and to make good any deficiency required for the payment of interest on the first consolidated mortgage bonds of the Peoria and Eastern and on the prior mortgage bonds (Article Second). While the agreement provides that the Big Four is to receive all earnings and income of the use and operation of the railroad, it is required to apply such receipts to the expenses of operation and payment of interest and, if any surplus remains, it is required to be paid to the Peoria and Eastern (Article Third). The agreement (Article Fourth) also requires the Big Four annually to make up and state all its receipts and disbursements and "to render proper accounts therof to the Peoria Co. and to the trustees of its said second mortgage as in said second mortgage required."

During the 50 years between the execution of the Operating Agreement and the commencement of the adjustment proceeding the Big Four and its lessee, the New York Central, operated the railroad of the Peoria and Eastern, making all necessary expenditures required for its maintenance, operation and improvement, crediting the Peoria and Eastern with all receipts from operation and making good any deficiencies required for the payment of interest on the first mortgage bonds and prior mortgage bonds. Annual accounts were filed with the Board of Directors of the Peoria and Eastern and with the trustees of the Income Mortgage, as required by the Operating Agreement and the Income Mortgage (Ex. 13, S. 178), and annual statements were furnished to stockholders.

At the hearings before the Special Master the Operating Companies offered in evidence their accounts for those years to which the director representing the Income Bondholders had objected, and also offered, as accounts stated, their accounts for each of the years back to 1926, accompanied by testimony that all of these accounts were kept in conformity with the regulations and requirements of the Interstate Commerce Commission and correctly set forth the amounts received and expended by the Operating Companies on behalf of the Peoria and Eastern. The Operating Companies also proved that the accounts had been duly rendered each year to the Peoria Company and to the Trustees of the Income Mortgage in accordance with the requirements of the Operating Agreement and of the Income Mortgage (R. 153-240).

At no time did the Income Bondholders or the accountants retained by them to investigate the accounts challenge the fact that the accounts as received in evidence accurately set forth the actual receipts

and disbursements of the Peoria and Eastern. Instead, the Bondholders undertook to prove that the accounts should be revised in large amounts in favor of the Peoria and Eastern by the application of methods and practices contended for by their witnesses upon the theory that the Operating Companies were required to operate their entire railroad system for the sole benefit of the Peoria and Eastern. The Operating Companies produced witnesses whose testimony demonstrated that the methods and practices which had been followed for more than 50 years were fair to both parties.

The claims asserted by the petitioners against the Operating Companies totaled millions of dollars. The findings of the Special Master on these claims, as slightly modified by the Special Court, allowed claims in the principal amount of approximately $130,000 and rejected the balance.

Jurisdiction of This Court.

Before discussing the merits of the pending application for certiorari, we beg leave to refer to the statutory provision upon which the petitioners base their claim of the Court's jurisdiction (Petition p. 19).

Article XV of the Bankruptcy Act, which was approved July 28, 1939 and expired by its own terms on July 31, 1940, provided a simple and inexpensive method for railroads which were solvent, but temporarily unable to meet maturing debts, to adjust such debts. The law authorized the approval of a plan of adjustment by a three-judge Special Court and specified the parties entitled to appeal and the method

by which appeal might be taken. Section 745 of the statute, upon which petitioners rely, provides:

> "Any final order or decree of the special court may be reviewed by the Supreme Court of the United States upon application for certiorari made by any person affected by the plan who deems himself aggrieved * * * "

Petitioners argue that they are "clearly aggrieved by this portion of the Plan" but wholly ignore Section 706 of the Act, the terms of which preclude an application by petitioners. That section provides:

> "No creditor shall be deemed to be 'affected' by any plan unless such plan proposes a modification of the evidence of debt or other instrument defining the rights of such creditor, or a modification of the security, if any, for the claim of such creditor."

The decree appealed from neither "proposes a modification of the evidence of debt or other instrument defining the rights" of the petitioners "or a modification of the security, if any", for the claim of petitioners.

The adjudication in the 1940 adjustment proceeding included a finding that the only claims affected by the Plan were the First Consolidated Bonds; the petitioners were authorized to intervene as persons in interest under Section 720, not as parties affected by the Plan. (*Ewen, et al.* v. *Peoria and Eastern Railway Co.*, 34 F. Supp. 332, cert. denied 311 U. S. 700; *In re Peoria and Eastern Railway Company,* 37 F. Supp. 917, cert. denied 314 U. S. 635.)

Issues Before This Court.

The question of jurisdiction to one side, the only real issue presented on this application is petitioners' contention that the decision sought to be reviewed is in conflict with decisions of this Court defining standards of duty imposed on certain fiduciaries and the corollary burden of proof resting on such fiduciaries.

Petitioners also assert error in the decision of the Special Court holding their claims barred by the doctrine of accounts stated and by the statute of limitations, and discuss the merits of some of their specific claims which were rejected by the findings of the Special Master as confirmed by the Special Court.

Duty of the Operating Companies and Burden of Proof.

In none of the cases relied upon by the petitioners (*Pepper* v. *Litton,* 308 U. S. 295; *Taylor* v. *Standard Gas & Electric Co.,* 306 U. S. 307; *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483; *Geddes* v. *Anaconda Mining Co.,* 254 U. S. 590, and others) was the management and stock control of the subsidiary company conferred upon the controlling company by the voluntary agreement of the security holders of the subsidiary company, as part of a transaction which included a contract for the joint operation of the business of both companies for their mutual benefit by the management of the controlling company.

The major error in the petitioners' contentions is the fallacious premise that the written instrument creating the relationship, and the circumstances surrounding its execution, are of no significance in de-

fining the rights and responsibilities of the parties, and that the mere existence of a fiduciary relationship completely delineates and defines such duties and rights without regard to contractual relationships established at arms-length.

In *Securities Commission* v. *Chenery Corp.*, 318 U. S. 80, this Court said, pages 85, 86:

> "But to say that a man is a fiduciary only begins analysis; it gives direction to further inquiry. To whom is he a fiduciary? What obligation does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

In support of their theory petitioners emphasize the Big Four's ownership of a majority stock interest but disregard the effect of the contract between the parties and the circumstances under which the Operating Companies acquired their majority stock interest.

In 1889 the predecessors of the present Income Bondholders had upon their hands a railroad venture which had been consistently unsuccessful and was subject to mortgage liens in a large amount (Finding 5). They formulated a plan of reorganization which depended for its success upon inducing the Big Four to undertake the operation of their railroad, and the Operating Agreement and other documents were executed. The security holders of the Peoria and Eastern agreed and intended that the Big Four should receive a controlling stock interest in the new company as an inducement to undertaking its operation (Exs. 3, 21); they knew and agreed that there would be a unified management and joint operation of the railroads of both companies; they knew and agreed that

the Operating Agreement contemplated and required benefit to both roads. The Operating Agreement expressly so recites (Ex. 11, S. 162).

On these undisputed facts both the Special Master and the Special Court held that the conventional fiduciary duties which might have arisen out of the mere fact of control were modified by agreement of the parties as shown by the terms of their contracts considered in the light of their respective situations at the time of making the contracts. The Special Court said (*Ewen, et al.* v. *Peoria and Eastern Railway Co., supra,* page 316):

> "We shall assume that, as its majority shareholder, the 'Central' would have been subject to the usual limitations of a trustee in any dealings between the two, had it not been for the powers granted it in the 'Agreement'; but both the Bondholders and the 'Peoria' concede that these to some extent modified its duty. A moment's reflection shows that if it were to be held strictly accountable as a fiduciary in the conventional sense, the 'Agreement' could not have been performed at all. Both parties entered into it, because, as it recites, they thought that it would be 'beneficial to the business and traffic of said railways that the same be put under one management'; and 'one management' presupposed that the 'Central' should have power to determine the interests of both in those mutual transactions which would constantly arise between the two. Moreover, it was apparent that those determinations could not be 'beneficial' at once to the 'business and traffic' of the 'Central' and of the 'Peoria,' unless the 'Central' were permitted to

> profit from the joint 'business and traffic.' Indeed there would have been no conceivable motive for its entering into the agreement at all, if it were bound to fix the terms of every transaction with an eye only to the interest of the 'Peoria.' "

Even if the agreement between the majority and minority interests in this case did not distinguish it from the decisions cited by petitioners there would still be no conflict between the conclusions of the Special Court and the principles laid down by this Court.

The limitation on the broadly stated doctrines of fiduciary duty and burden of proof in the cited cases has been recognized by this Court in the recent case of *Comstock* v. *Group of Institutional Investors,* 335 U. S. 211, 228, 237. There both the majority and the minority quoted the statement in *Pepper* v. *Litton, supra,* pointing out that the doctrine in the *Taylor* case was based on "the equities of the case—the history of spoliation, mismanagement, and faithless stewardship of the affairs of the subsidiary." Here the Special Master found that "there has been no evidence of fraud or of calculated overreaching in the entire case" (S. M. 287), and the Special Court found "no justification for saying that it [New York Central] ever deliberately tried to despoil the 'Peoria'; or that the matters with which we do charge it show evidence of any corrupt purpose. * * * on the whole, it acquitted itself creditably in a long series of extremely complicated transactions." (*Ewen, et al.* v. *Peoria and Eastern Railway Co., supra,* 326.)

The proof in this case also follows the pattern of proof in the *Comstock* case, as quoted and approved by this Court (pp. 221, 222, 225):

> "The expert accountant called by Comstock produced a large number of exhibits which he

had prepared from the books, records and reports of the individual companies and explained in connection with them the inferences he had drawn from his studies and expressed his opinions tending to support the Comstock charges. * * *

"The Group of Institutional Investors * * * to sustain the burden of Missouri Pacific defense called as their witnesses on the trial the railroad men who had engaged, each in his own department, in all of the transactions and railroad operations and the records made thereof throughout the period involved, and they testified of and concerning matters with which they were intimately familiar. * * *

"* * * But the disputes and conflicts of testimony in respect to the accounts and the inferences to be drawn were all issues of fact. * * *

"Comstock's contention that the court erroneously put the burden of proving his charges on him rather than requiring the Missouri Pacific to proceed first to disprove them, is without merit. As the execution of the promissory notes was admitted and at least formal proof of all of the items of advancements making up the debt had been in the record of the Section 77 proceedings for many years before the hearing, the court required only that all the records of the transactions that were questioned be made available for the hearing so that there was the equivalent of a full disclosure by the Missouri Pacific before Comstock was required to proceed with his proof of the charges. In its findings the court stated the facts as it found them to be proven by the whole evidence."

In the present case formal proof of the accounts was made and all the basic records were made available to petitioners' accountants who spent more than a year in investigating them. The testimony offered by petitioners' witnesses consisted principally of tabulations taken from the Operating Companies' records accompanied by the opinions of these witnesses that the various charges and credits should have been made upon bases suggested by them. The respondents then offered the testimony of railroad operating officers explaining the bases upon which the charges and credits were made and demonstrating the fairness of the transactions to both parties. Upon the whole evidence the Special Master's findings of fact dismissing the bulk of the claims asserted were confirmed by the Special Court.

Accounts Stated.

The subsidiary question raised by petitioners with respect to accounts stated is unimportant to the consideration of this petition, since the doctrine of accounts stated was not actually applied to their claims.

The contention of petitioners is in reality a complaint against the agreements made by their predecessors more than fifty years ago. The Operating Agreement provides for an annual accounting. Each year the Big Four is required to "make up and state all its receipts for earnings and income * * * and for the cost and expense of using, operating and maintaining said lines of railroad * * * and to render proper accounts thereof to the Peoria Co. and to the trustees of its said second mortgage as in said second mortgage required" (S. 166).

The Income Bond Mortgage, which by its terms

is subordinate to the Operating Agreement (S. 185), requires the directors of the Peoria and Eastern to ascertain the net earnings of the Peoria and Eastern and to furnish the trustees annually with a statement showing such net earnings. Detailed procedure for objecting to the accounts and for settlement of disputes, and the exclusive remedy to be used in case of non-settlement, are prescribed by Article Sixth of the Income Mortgage (S. 193-195).

Upon the hearings the Operating Companies proved both by its own officers and by an officer of the Income Mortgage Trustee that the annual accounts had been duly filed year by year in accordance with the terms of the contracts. The claim of error in the holding with respect to accounts stated cannot be sustained without disregarding or voiding the provisions of the contracts, and no justification has been shown for doing so.

Statute of Limitations.

The claims actually asserted and litigated in this proceeding are claims of mismanagement, overreaching and breach of duty and the proceeding is, in substance, an equity proceeding.

The Operating Companies were required to file annual accounts of the result of their operations, and any interested security holder of the Peoria and Eastern could have advanced and litigated the claims now asserted at any time after the filing of each annual account. Accordingly, the Special Court properly held the equity ten year Statute of Limitations applicable to these claims. (New York Civil Practice Act, Sec. 53.)

The petitioners argue that the statute of limitations is inapplicable because the adjustment proceed-

ing, from which this proceeding stems, was brought under the provisions of the Bankruptcy Act, and cite *Holmberg* v. *Armbrecht,* 327 U. S. 392; *Guaranty Trust Co.* v. *York,* 326 U. S. 99; *Vanston Bondholders Protective Committee* v. *Green,* 329 U. S. 156. These cases do not support the view urged by the Bondholders. The *Holmberg* case deals with a federally created right under the Federal Farm and Loan Act; the *Guaranty Trust* case holds that where the rights are not federally created but are created under state law, as admittedly is the situation here, the applicable state statute of limitations does apply; and the problem in the *Vanston* case is whether a claim assumed valid under state law should be recognized under the Bankruptcy Law.

Specific Claims of Petitioners.

The report of the Special Master with respect to petitioners' specific claims, as confirmed by the Special Court, consists principally of findings of fact which "the seasoned and wise rule of this Court makes * * * final here in the absence of very exceptional showing of error." *Comstock* v. *Group of Investors, supra,* 214; *Anderson* v. *Mt. Clemens Pottery Co.,* 328 U. S. 680, 689.

The report of the Special Master demonstrates that these findings were made after full and careful consideration of conflicting and detailed evidence submitted by the respective parties on each of the claims involved, and "this Court does not grant certiorari to review evidence and discuss specific facts". *Wisconsin Electric Co.* v. *Dumore Co.,* 282 U. S. 813.

Conclusion.

The decision which this Court is asked to review involves the meaning and effect of contracts between the parties, and the determination of issues of fact resolved after consideration of voluminous conflicting evidence. "The asserted conflict in decisions arises from differences in states of fact, and not in the application of a principle of law." *United States* v. *Johnston,* 268 U. S. 220, 227, and the decision here is of interest to no one but the immediate parties.

We respectfully submit that no reasons have been shown which warrant review by this Court, and the petition for writ of certiorari should be denied.

Respectfully submitted,

GERALD E. DWYER,
Counsel for Respondents, The New York Central Railroad Company and The Cleveland, Cincinnati, Chicago and St. Louis Railway Company.

SAMUEL H. HELLENBRAND,
LEE P. GAGLIARDI,
Of Counsel.

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BRIEF OF THE PEORIA AND EASTERN RAILWAY COMPANY WITH RESPECT TO THE PETITION FOR WRIT OF CERTIORARI OF THE INCOME BONDHOLDERS OF THE PEORIA AND EASTERN RAILWAY COMPANY.

Foreword.

This proceeding was originally commenced in 1940 by the Peoria* pursuant to Chapter XV of the Bankruptcy Act (53 Stat. 1134) for approval of a Plan of Adjustment which had been approved by the Interstate Commerce Commission (239 I. C. C. 303).

* We have used the following abbrevations:

P. & E., or the Peoria—the respondent, The Peoria and Eastern Railway Company.

Big Four—the respondent, The Cleveland, Cincinnati, Chicago and St. Louis Railway Company.

[Footnote continued on following page.]

The adjustment was sought because in 1940 the First Mortgage Bonds of the Peoria were about to become due, and the operating agreement of 1890 between the Peoria and the Big Four was to expire (S. M. 6, 7).*

The District Court approved the Plan of Adjustment (R. 5-7). *Ewen* v. *Peoria and Eastern Railway Co.,* 34 F. Supp. 332. The plan, however, did not liquidate the operating deficit accumulated against the Peoria under the operating agreement or the reserve and depreciation accounts in its favor. The Court, therefore, left these questions open, providing that one director of the Peoria should represent the Income Bondholders, who had been permitted to intervene in the proceeding. Section 24 of the decree of the Special District Court, as amended in 1941, provides as follows:

> "All questions concerning the amount and validity of the accounts between the 'Big Four', the New York Central Railroad Company and the Petitioner are not determined in these proceedings and are hereby specifically left open and re-

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[Footnote continued from preceding page.]

New York Central—the respondent, The New York Central Railroad Company, controlling stockholder of the Big Four, and after 1930 lessee of its property, including its interest in the P. & E. (*infra,* p. 12).

Operating Companies—New York Central and Big Four.

Income Bondholders—petitioners, a Protective Committee of the P. & E.'s Second Mortgage non-cumulative 4% Income Bonds, due 1990.

* "S." references are to the material in Supplement I, and "S. M." references are to the Special Master's report, Supplement II. "R." references are to the unprinted record, and are keyed to the items listed in the Praecipe, which is printed at S. 213. The numeral following the letter R. refers to the item in the Praecipe bearing that number.

served for future determination. Should the New York Central Railroad Company and/or the 'Big Four' seek or attempt, in any year or at any time or times hereafter, to withdraw any part of the earnings or assets of the Petitioner by way of recoupment or repayment of said inter-company accounts, then and in such event said New York Central Railroad Company and/or 'Big Four', upon objection by the representatives of the Income Bondholders elected to the Board of Directors, must prove and establish their right to do so" (S. 154).

Early in 1943 the New York Central filed the annual account between the roads required by Article Fourth of the operating agreement, to which the director of the Peoria who had been appointed by the Income Bondholders filed objections. Thereafter, and on April 1, 1943, the New York Central petitioned for a supplemental order appointing a master under the decree to hear and report upon the validity and amount of their claim against the Peoria in the sum of $2,356,687.33, as of December 31, 1942 (S. 79-91); and by order entered May 21, 1943, the District Court appointed a master to conduct such an inquiry (S. 92-4). The parties to the accounting were the New York Central, a Protective Committee of the Income Mortgage Bondholders, and the Peoria.

On July 2, 1943, the Court appointed the undersigned, as an independent attorney to represent the Peoria, upon the petition of the New York Central, with the understanding that he should "to the best of his ability as an attorney, protect the interest of the Peoria and Eastern * * * and * * * look only to the best interest of the Peoria and Eastern without regard to any * * * control," by the New York Central (S. 96; 99; 12).

Thereafter, as such independent counsel, the undersigned considered the proposed accounts, investigated the records of both the Peoria and the operating companies, conferred with operating, accounting and other officials of the Peoria and the operating companies, considered the report prepared by accountants for the Income Bondholders and generally investigated all possible issues.

With respect to each issue, consideration was given not only the over-all interests of the Peoria in relation to past transactions, but also in relation to its future welfare, insofar as that welfare may be affected by this proceeding, without regard to the special interests of any particular group of security holders.

In endeavoring to protect the Peoria's entire interests we have not been unmindful of the fact that this road has been operated for fifty years, as a part of a system under the operating agreement, and that the District Court in its decree of July 29, 1940, approved an extension of that agreement for an additional twenty years.

Under these circumstances, the mere fact that the Income Bondholders saw fit to assert a particular claim did not, in our view, create an identity of interest between the P. & E. and the Income Bondholders, or provide a sufficient basis for adopting it. For the same reasons, where a claim of the Income Bondholders appeared to be detrimental to the best interests of the Peoria, or without merit, we have not hesitated to oppose it.

ARGUMENT.

I.

The Income Bondholders assert as their principal reason for the granting of certiorari that the District Court erred in failing to find that the Operating Companies are fiduciaries of the P. & E. and that as such fiduciaries the Operating Companies must be held to the fiduciary standards laid down by such decisions of this Court as *Pepper* v. *Litton,* 308 U. S. 295; *Schwabacher* v. *United States,* 334 U. S. 182; *Geddes* v. *Anaconda Mining Co.,* 254 U. S. 590; *Comstock* v. *Group of Investors,* 335 U. S. 211.

We believe this contention to be contrary to the facts upon which the relationship of the parties is based, contrary to the actual day to day construction and operation of the P. & E. under the operating agreement for over fifty years and not in the best interests of the P. & E., now or in the future.

We believe that the case involves only the construction of a special contract which was born of the mutual interests of the parties and which contemplated the operation of the P. & E. as part of a single system.

A determination of this basic question involves an examination of the history of the P. & E. prior to the commencement of this proceeding.

The immediate predecessor of the Peoria was the Ohio, Indiana and Western Railroad* which owned and operated a line from Peoria, Illinois to Springfield, Ohio. That road was apparently born of early insolvencies and, in its turn, reached that stage by 1888.

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* Sometimes referred to as the "O. W. & I."

Security holders, in a salvage effort, formed a Re-organization Committee known as the Coster Committee.

The Re-organization Plan proposed by this Committee, and the contract with the Big Four, which incorporated the plan into its terms (S. 156-159; Ex. 3, R. 23) is, in our view, of aid in understanding both the relationship of the parties and the legal principles which have governed them.

The plan indicates that the O. W. & I. was in danger of foreclosure and eventual liquidation and that the security holders, of various classes desired to protect their interests. It contemplated a separation of the O. W. & I. into two lines, to be operated separately, and independently. One part, known as the Eastern line or Springfield division, ran east of Indianapolis and was to be conveyed in fee to the Big Four. The Western line was to be conveyed to a corporation (now the P. & E.) to be formed by the Committee and to be operated under a "lease, contract or other arrangement" by the Big Four (S. 156-159; Ex. 3, R. 23).

The plan provided for the issuance of new securities, including the so-called Income Bonds in the amount of $4,000,000 and common stock in the amount of $10,000,000.

The plan itself shows clearly that it was contemplated that one-half of this stock would go to the then holders of common stock of the O. W. & I., at the rate of one share of new stock for two of the old, and that one-half of the new stock was "to be used under proposed arrangement with C. C. C. & St. L. Ry." It thus appears that the plan itself, later effectuated by the action of the security holders, contemplated not only that the new road would be operated by the Big

Four but that the Big Four was at the outset, to own at least one-half of the common stock of the new railroad. Thus the O. W. & I. shareholders, who by exchange became P. & E. shareholders, knew that the Big Four was to have both a stock interest and at the same time a contract to operate the road.

This basic intention and consideration is plainly stated in the contract between the Coster Committee and the Big Four, dated October 30, 1889, of which, as we have said, the Re-organization Plan was a part (S. 156-9).

Thus the contract shows that at the very inception of the relationship it was intended by the Big Four that it would not buy the Eastern line or operate the Western line under a separate corporate form, unless it had one-half stock ownership in the new Western company. The contract provided in part:

> "* * * when the Committee shall have so far carried out the said reorganization as that the said Western line and the said Eastern line shall have become or can be separated, then upon transfer and delivery to it of one-half of the stock of the Company owning said Western line issued under said reorganization, it will purchase or otherwise take over the said Eastern line, subject to and charged with a purchase money lien on the property only amounting to five million dollars. * * *" (S. 156, 7)

and also declared that the Big Four

> "* * * will also simultaneously enter into a lease or other operating contract whereby it shall undertake the operation and management of said Western line and agree (1) that the net earnings of said Western line shall be applied likewise to

> the payment of the interest to accrue on the said prior bonds, also on one million dollars other prior bonds having a lien on the Western line only, and on said new First Consolidated Mortgage Bonds, and (2) that the balance of such net earnings from the Western line and income derived from the lien on the Eastern line shall after payment of said interest be paid over to the Western Company" (S. 157).

At the same time the intention of the parties with respect to the operation of the Western Company (the P. & E.) was defined by stating that the contract:

> "* * * shall also contain covenants whereby said Cleveland Co. shall undertake to maintain said Western line and the rolling stock necessary for the operation of said Western line, and pay all taxes thereon or upon the earnings or income of said Western line as well as rentals or other like charges, and to indemnify and save harmless said Western Company from all claims arising out of the operation or management thereof, and also such other covenants, terms and conditions as may be reasonably required by said Committee, pursuant to the plan of reorganization, or for the more perfect protection of the holders of said prior bonds and said new First Consolidated Mortgage Bonds and new income bonds and stock to be issued under said plan of reorganization, and the rights and interests intended to be granted to them" (S. 158).

The arrangements contemplated by the plan and the contract were effected in 1890. At that time the mortgages were executed, the new bonds, including the Income Bonds, were issued, the Big Four bought the Springfield division outright, received a one-half

common stock interest in the new Western Company (the P. & E.), and entered into the operating agreement (S. 160-171) with it on February 21, 1890.

The transaction, viewed as a whole, indicates that the Big Four, then operating connecting and related lines in the same territory, would operate the P. & E. for the mutual advantage of the two roads, and indeed, the operating agreement recited:

> "Whereas, the railways of the parties hereto connect at Indianapolis, and it will be beneficial to the business and traffic of said railways that the same be put under one management: * * *" (S. 162).

The operating agreement comprehends the following rights and obligations:

> (1) The Big Four received the right to "use" the P. & E., subject to the other terms of the agreement.
>
> (2) The Big Four agreed that for 50 years beginning on April 1, 1890, it would operate and use the road in accordance with law, providing at its own cost all rolling stock and equipment, labor and supplies, and that it would maintain the road, and its rolling stock, pay all taxes, and indemnify the P. & E. from all claims arising out of management.
>
> (3) The Big Four agreed to pay the interest on the First Mortgage consolidated bonds.
>
> (4) The Big Four was to receive all net income, and after paying the senior fixed and other charges and expenses of operation, agreed to pay the balance of the net earnings, in any year, after recoupment of all advances (1) on the interest

due to the Income Bonds and (2) the remaining balance, if any, to the P. & E.

(5) The Big Four agreed to render proper accounts of earnings and disbursements to the P. & E. and the trustees of the Second Income Mortgage, within 60 days after December 31, of each year.

(6) The Big Four agreed to look only to such future net earnings as were not required for payment of fixed charges, for reimbursement of sums advanced under the agreement and the P. & E. agreed to charge all such earnings for that purpose, such advances to carry interest at 6%.

(7) The P. & E. agreed to let the Big Four use its name.

(8) The P. & E. had the right to resume operations in the event of default by the Big Four and in that event, or at the termination of the agreement, the Big Four agreed to return all rolling stock, etc. or its equivalent.

On the same day the operating agreement was executed between the Big Four and the P. & E., Income Bonds were created by indenture, as provided in the Plan of Reorganization (S. 178-201; Exs. 3, 13). This document recited the intention of the P. & E. to issue $4,000,000 of bonds "with interest thereon at a rate not exceeding four percent in any one year, payable * * * only out of the net earnings and income of the Railway Company as the same shall be ascertained for each particular year * * * such interest to be absolutely non-cumulative" (S. 179). The mortgage was not only subordinate to prior liens but to the operating agreement.

It was provided that the Board of Directors should ascertain and declare the net earnings after all charges and after reimbursement of all advances of the road by December 31st of each year, and pay the interest due by April 1st of each year. The Railway Company was required to furnish the trustee with a statement of earnings each year and it was provided that the trustee, on its own motion, or after notification by 20% of the bondholders, should, if dissatisfied, notify the Railway Company of such objection. If no adjustment was made the trustee, if called upon so to do by 20% of the bondholders, was authorized and directed to sue for an accounting. This procedure and this remedy were exclusive of all others (S. 192-5).

Also in conformity with the reorganization plan the Big Four, simultaneously with the execution of the operating agreement, acquired 50% of the common stock of the P. & E. At about the same time it acquired for cash one additional share of that stock, thus achieving complete voting control (Findings of Fact 16, 17, 18, S. 119-120).

Thus, at this stage in the history of this relationship we find the Big Four, presumably a solvent road operating in adjacent territory and connecting with the old O. W. & I., taking that line over by purchasing the Eastern half and by agreeing to operate the Western half, transformed into a new company, on a mutual benefit basis, including as an express condition of the transaction, ownership of at least one-half of the equity and voting power represented by the common stock.

The P. & E. from the outset, under these arrangements, has never operated its properties, nor was it ever intended to. On the contrary, it seems clear that it was the express intention and desire of all of

the parties, including the share owners and bondholders of the P. & E., that, however the legal relationship might be defined, the Big Four was to operate the road as part of a system supplying, both capital and management, and having only the duty to pay over or account for the net income on the terms specified in the contract. For this assumption of the obligation of management and of financing the venture, the Big Four received the right to operate the line as part of its own system.

There was no change in these basic agreements and arrangements until January 2, 1930, when the Big Four leased to the New York Central Railroad all its line of railroad and other property, including a transfer of its rights under the operating agreement (Finding of Fact No. 19; S. 120; Ex. 15). Since that time the Central has succeeded to the rights and responsibilities of the Big Four under the arrangements made in 1890, including the operating agreement.

As already noted, the District Court by its decree in the adjustment proceeding continued the operating agreement in effect for an additional term of twenty years (S. 106; 134-151; 172-177).

From the foregoing history of the Peoria company the following facts have particular significance in determining the legal relations between the parties.

The Big Four, in 1889, agreed to purchase one-half of the O. W. & I. and to operate the other, providing it received, among other things, one-half of the common stock of the new company, the P. & E., and the right to use the lines of the P. & E., presumably as part of its system.

It is thus clear that the security holders of the O. W. & I., who became the security holders of the P. & E., bargained at the outset not for merely an operating agent, but for an operating agent which would be a half owner in the business. The security holders knew, too, that the operating agent was a connecting, and in some directions, a competing carrier. Notwithstanding this they consented to a plan of reorganization which contemplated management of their road by such a competing carrier.

We come then to the operating agreement. This plainly, and in light of the circumstances surrounding and preceding its execution, did not create any express trust. It was an arrangement based on the fact, as it recited, that it would be mutually beneficial for these connecting carriers to be operated under one management. It was a bargain, dictated by neither party, whereby each gave and each received. The P. & E. received guarantees of payment of its fixed indebtedness; guarantees of maintenance and operation at the sole expense of the Big Four, including indemnity against deficits and finally the right to any net earnings after deduction of all expenses, advances and fixed charges.

On its side, the Big Four received the right to use the road, with which it connected, during the term of the agreement. This was, presumably, a valuable right, and one for which the Big Four was willing to make the commitments set forth in the agreement.

At this point, without considering the effect of further voting control, it seems clear that the Big Four had bargained for and obtained absolute control over the operations of the P. & E. during the term of the agreement. By its bargain, and as the result of the very nature of the arrangement, it had

both the right and the duty to make every decision affecting the operation and maintenance of the P. & E. Further, it was plain from the very nature of the relationship that the decisions made by the Big Four with respect to the P. & E. would affect not only the P. & E. but its own lines. The arrangement could not have existed otherwise.

We believe, therefore, that at least insofar as the operating agreement governed the relationship of the parties it imposed no extraordinary fiduciary obligation upon the operating companies. The question next arises, however, as to the extent, if any, to which domination by the operating companies through stock control created a fiduciary relationship out of which a higher duty arose.

We suggest that, in view of the circumstances and conditions surrounding the execution and performance of the operating agreement, no clear fiduciary duty existed between the parties with respect to matters arising under the operating contract. Clearly the fact of domination and control created no express trust since such a trustee may deal itself with the property of a beneficiary only at its peril. The arrangement here not only contemplated but required that the Operating Companies deal in a multitude of vital matters affecting important property rights as well as the day to day business of the parties. This clearly negatives the trust conception applied in the cases cited by the petitioners.

Even if it is concluded that, by reason of domination and control, a fiduciary relationship exists, the mere statement of that fact does not solve the problem. As this Court observed in *S. E. C.* v. *Chenery Corporation,* 318 U. S. 80, 85-6: "* * * to say that a man is a fiduciary only begins analysis; it gives direction

to further inquiry. * * * What obligations does he owe as a fiduciary? In what respect has he failed to discharge these obligations? And what are the consequences of his deviation from duty?"

If there were no operating agreement the case would be merely one of domination and control of a parent by a subsidiary giving rise to a strictly enforceable fiduciary duty (*Geddes* v. *Anaconda Copper Mining Co.*, 254 U. S. 590 (1921); *Chelrob, Inc.* v. *Barrett*, 293 N. Y. 442 (1944)). However, this is not a situation where the parent was free to deal with a subsidiary or not, as it saw fit, and where in consequence it could be required to deal only as a fiduciary. Here the underlying and basic circumstances contemplated by the parties at the outset required the parent to deal with the subsidiary, and, moreover, required the parent by almost every decision it made to make a decision which not only affected the subsidiary but also affected itself. In such a situation the fiduciary obligation is clearly affected and limited by the contractual obligations between the parties (*Blaustein* v. *Pan Am. etc.*, 293 N. Y. 281).

The suggestion in such cases as *Chelrob* v. *Barrett*, *supra*, that the sole test of the propriety of the parent's conduct is whether it is fair to the subsidiary would, in these circumstances seem inapplicable to all transactions which came clearly within the scope of the operating agreement. In such cases, it would seem that the intention of the parties, the requirements of the underlying situation and the terms of the agreement require that in considering any given transaction between the operating companies and the P. & E., effect be given to all these considerations and

that an effort be made to ascertain the fairness of the transaction in the light of its effect upon both parties.

An examination of the cases cited by the petitioners indicates that where a fiduciary duty has been declared there has been either fraud (and there is no suggestion of fraud on this record) or direct damage to the property of a subsidiary by a parent, or of the property of a minority by a majority interest. None of the authorities so holding involve a situation, as here, where the underlying contractual relations between the parties required operation of all of the business of one by the other.

It is, therefore, our view that the relationship of the parties, considered in the light of its inception and in the light of the requirements of the P. & E., does not involve any fiduciary duty but involves only a contractual relationship based on a mutual benefit. It is our view, too, that any other construction of the agreement would be necessarily detrimental to the best interests of the P. & E. on the whole, since if a strict fiduciary relationship existed here the Operating Companies would not and could not operate the P. & E. on a basis which would justify the continuance of the P. & E. As we have previously indicated, the relationship between the parties did not involve the fiduciary obligations contended for by the Income Bondholders. Indeed, to apply the principle to the special contractual situation existing here would, as the District Court pointed out, require that "after the lapse of fifty years, the contract should be unravelled." (*Ewen* v. *Peoria and Eastern Railway Co.*, 34 F. Supp. 332, 335.)

II.

It is suggested by the Income Bondholders that the District Court was also in error as to burden of proof; in holding, unnecessarily, that the Income Bondholders were bound by the terms of their mortgage, and that the ten-year New York State Statute of Limitations should not have been applied (Petition, pp. 30-40).

In making these contentions we believe that the Income Bondholders have lost sight of the fact that the statement of these accounts is only a part of the effectuation of a plan of adjustment which must, under Section 710(2)(c)(ii) of the Bankruptcy Act (53 Stat. 1134), be "in the public interest and in the best interests of each class of creditors and stockholders".

The hearings before the Special Master consumed many weeks. More than 4,000 pages of testimony were taken and hundreds of exhibits were introduced by the parties. Every issue which could conceivably be raised was exhaustively investigated on the record and all the evidence which could possibly be assembled by any of the parties was laid before the Court. The Special Master in a 300-page report analyzed all of the evidence on every issue. The Court, with a minor exception, which made no difference to the P. & E., confirmed the Master's report, after a full presentation of the issues by counsel orally and in voluminous briefs.

All of this resulted in enormous expense which was borne by the P. & E. and which far exceeded the comparatively small amount of adjustments made in the accounts.

In this connection, we respectfully point out that as a result of the proceedings by the Income Bondholders, the P. & E. received adjustments in its favor of only $176,260.36, including interest (S. 8). At the same time, due to the fact that the sum of $1,579,162.32, representing its net earnings for 1942, 1943 and 1944 was held in a special account, and not applied in reduction of advances made by the Operating Companies, the P. & E. was deprived of interest on that sum (S. 77-78). This amounted to $342,637.47. The P. & E. has thus lost, as a result of these proceedings, taken at the instance of one class of creditors, the sum of $166,377.11, being the difference between the adjustments of $176,260.36 and $342,637.47, without even considering the other expenses of the proceeding.

We, therefore, suggest that the phase of the adjustment proceedings which the Income Bondholders seek to have this Court review has not been "in the public interest and in the best interests of each class of creditors and stockholders", as required by the Act (53 Stat. 1134). We suggest, also, that a further examination of the evidence could only result in additional heavy expense to the P. & E., without any substantial likelihood of any improvement in the plan of adjustment or of financial benefit to the P. & E., as a whole.

Respectfully submitted,

F. W. H. ADAMS,
Counsel for The Peoria and Eastern Railway Company.

PETER KEBER,
Of Counsel.